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Supreme Court of the United States.

OCTOBER TERM, 1944.

RAYTHEON PRODUCTION CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

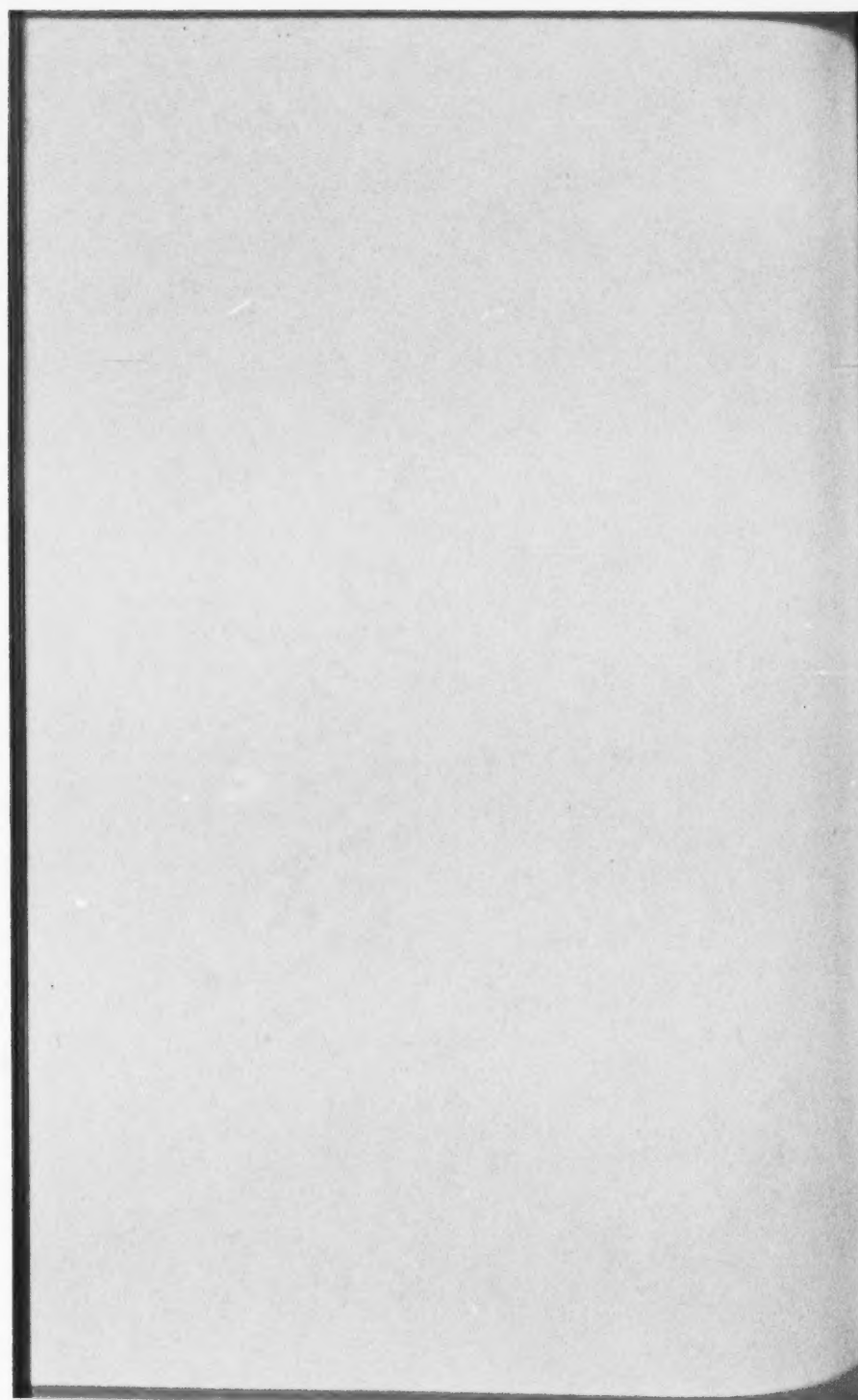
PETITION FOR WRIT OF CERTIORARI TO THE
CIRCUIT COURT OF APPEALS FOR THE FIRST
CIRCUIT

AND

BRIEF IN SUPPORT THEREOF.

EDWARD C. THAYER,

Attorney for Petitioner.



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Supreme Court of the United States.

OCTOBER TERM, 1944.

RAYTHEON PRODUCTION CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

*To the Honorable the Justices of the Supreme Court of
the United States:*

The petitioner, Raytheon Production Corporation, prays that a writ of certiorari may issue to review the decree of the Circuit Court of Appeals for the First Circuit entered July 28, 1944, in the case between the above-named parties, docketed therein as No. 3956. Said decree affirmed a decision of the Tax Court of the United States that an amount received in settlement of a damage suit under the federal anti-trust laws (charging damage to business good will through illegal licensing agreements) is taxable income in full in the absence of any showing of cost or other basis of the good will injured.

Opinions Below.

The findings and opinion of the Tax Court are reported in 1 T.C. 952, and printed in the Record, pp. 16-31. The opinion of the Circuit Court of Appeals is not yet officially reported (but see 1944 C.C.H. ¶ 9424). It is printed in the Record, pp. 139-148.

Jurisdiction.

This Court has jurisdiction to review said decree under U.S. Code, Title 28, Sec. 347.

This application is made within three months after the entry of such decree, as required by Section 350.

Question Presented.

Is an amount received in settlement of a suit under the federal anti-trust laws (charging tortious injury in damaging the valuable good will of a radio business but not involving accounting for any income or compensation for taking or conversion of any asset) income in the absence of showing of cost or other basis of the good will?

Statutes Involved.

The statute involved is the Revenue Act of 1936, Secs. 22, 111, 112, and 113. The relevant parts of these sections are set out in the appendix (*infra*, p. 13).

Statement.

The petitioner, Raytheon Production Corporation, came into existence as a result of a series of tax-free reorgan-

izations having no effect upon this case (R. 140). Like the court below, we will refer to any one of the original or successive companies as "Raytheon." The original Raytheon Company was a pioneer manufacturer of a rectifying tube which made possible the operation of radio receiving sets on alternating house current. In 1926 and 1927 it was doing a large and profitable business producing over half the rectifying tubes being used (R. 41). This business continued in 1928 on a diminishing scale. Earnings were: 1926, \$450,000; 1927, \$150,000; 1928, under \$10,000 (R. 40, ⁴⁴45). It was producing these tubes under patents of its own, free of any license fees. Radio Corporation of America (R.C.A.) had many patents covering most of the practical circuits used in radio sets (R. 42), and it developed a competitive tube which produced the same kind of rectification as Raytheon's.

Early in 1927 R.C.A. offered licenses to set manufacturers under its patents and cross-licensing agreements with General Electric Company, Westinghouse, and American Telephone & Telegraph Company. In the licensing agreement it incorporated "Clause 9," which provided that the licensee was required to buy its tubes from R.C.A. (R. 50). Clause 9 was held to be illegal in *Lord et al. v. Radio Corporation of America*, 24 Fed. (2d) 565 (D.C. Del.); affirmed, 28 Fed. (2d) 257 (C.C.A. 3); certiorari denied, 278 U.S. 648.

In 1928 practically all manufacturers were operating under R.C.A. licenses; and, as a consequence of the restriction in Clause 9, Raytheon was left with only replacement sales, which soon disappeared (R. 43). When Raytheon found it impossible to market its tubes in the early part of 1929, it obtained a license from R.C.A. to manufacture tubes on a royalty basis under the latter's patents. The license agreement contained a release of all claims of Raytheon against R.C.A. by reason of illegal acts of

the latter under Clause 9. But a side agreement provided that, if R.C.A. were to pay compensation to any other company on account of "Clause 9" damages, the right of Raytheon to assert its claim would be reinstated (R. 51). In 1931 R.C.A. admitted making cash settlements of other claims (R. 56). On December 14, 1931, suit was brought on the Raytheon claim against R.C.A. in the United States District Court for the District of Massachusetts for triple damages under the Sherman and Clayton Acts, *ad damnum* \$15,000,000. The declaration alleged that the plaintiff had by 1926 created and then possessed a large and valuable good will in interstate commerce in rectifying tubes for radios and had a large and profitable established business therein; that the defendant conspired to destroy the business of the plaintiff and others by a monopoly of such business and did suppress and destroy the existing companies; that by the early part of 1928 the tube business of the plaintiff and its property and good will had been totally destroyed at a time when it had a present value in excess of \$3,000,000 (R. 141). The suit was brought by the petitioner's predecessor, a Massachusetts corporation, but wholly for the benefit of the petitioner. The case came before this Court on a preliminary issue, 296 U.S. 459, and thereafter was referred to an auditor, who found that Clause 9 was not the cause of damage to the plaintiff but that the decline in the plaintiff's business was due to advancement in radio art and competition. He also found, however, that, if the plaintiff were entitled to recovery, the damages would be \$1,000,000 (R. 142). A jury trial had been claimed, and it was open to the jury to come to different conclusions (R. 80, 83).⁸² In the spring of 1938, just prior to the time for the commencement of the trial before a jury, officers of the Raytheon affiliated companies began negotiations for the settlement of the litigation with R.C.A. In the meantime, a suit brought by R.C.A. against

the petitioner for the non-payment of royalties resulted in a final judgment of \$410,000 in favor of R.C.A. The parties finally agreed on the payment by R.C.A. of \$410,000 in settlement of the anti-trust action, R.C.A. stating, however, that it wanted some of Raytheon's patent rights "thrown in" to R.C.A. (R. 60). Patent license rights were included in the settlement, but R.C.A. declined to allocate the amount paid. The agreement of settlement contained a general release of all claims between the parties (Exs. 19, 20, 24, R. 97-105).

The officers of the Raytheon companies testified that \$60,000 of the \$410,000 was the maximum worth of the patents (R. 68, 78). In the proceedings in the Tax Court the Commissioner admitted that the value of the patent rights did not exceed \$60,000 (Answer, paragraph V B, R. 13).

The petitioner returned \$60,000 of the \$410,000 as income from the patent rights and treated the remaining \$350,000 as a realization from a chose in action and not as taxable income. The Commissioner determined that the \$350,000 constituted income on the following ground only: "It is the opinion of this office that the amount of \$350,000 constitutes income under Sec. 22(a) of the Revenue Act of 1936. There exists no clear evidence of what the amount was paid for so that an accurate apportionment can be made as to a specific consideration for patent rights transferred to Radio Corporation of America and a consideration for damages. The amount of \$350,000 has therefore been included in your taxable income" (R. 9).

The Tax Court sustained the Commissioner on the grounds (1) that in view of the general language in the instruments of release "We are unable to allocate any portion of the settlement to non-taxable capital recovery in the face of the presumption that the Commissioner's determination to the opposite effect is correct" (R. 27), and

(2): "If we assume that capital recovery is involved and contained in the compromise moneys, only that portion above basis may be left untaxed" (*sic*) (R. 29).

The Circuit Court of Appeals affirmed the Board of Tax Appeals, not on the ground that there was any lack of evidence that the \$350,000 was received in settlement of the suit and constituted a return of capital involving no question of lost profits (R. 145), but on the ground: "Although the injured party may not be deriving a profit as a result of the damage suit itself, the conversion thereby of his property into cash is a realization of any gain made over the cost or other basis of the good will prior to the illegal interference" (R. 146). The court illustrated: "Thus A buys Blackacre for \$5,000. It appreciates in value to \$50,000. B tortiously destroys it by fire. A sues and recovers \$50,000 tort damages from B. Although no gain was derived by A from the suit, his prior gain due to the appreciation in value of Blackacre is realized when it is turned into cash by the money damages" (R. 147).¹⁴⁶

Specification of Errors.

The court erred in deciding that in this case any taxable income was derived or, in the case stated for illustration, would be derived under the Revenue Act of 1936.

Reasons for Granting the Writ.

The decision below is so unprecedented¹ and involves so important and basic a question of tax law, namely, whether an injured taxpayer is to be taxed upon compensation

¹ The Circuit Court of Appeals cites no decided case for its pronouncement. The texts cited and the cases discussed therein do not support the proposition.

in mitigation of damages inflicted upon it by a wrongdoer, that we submit it ought to be scrutinized and passed upon by this Court.

It has been decided in other Circuit Courts of Appeals that damages for injury to an intangible capital asset do not constitute income. The decision below is in conflict with these decisions.²

The decision is also in conflict with principles announced by this Court.³

The results that will flow from this decision in the ordinary case are such that the intention to produce them can hardly be imputed to Congress. Thus, suppose that at the same time A bought Blackacre, as stated in the court's illustration, X bought Whiteacre, which similarly appreciated in value to \$50,000, and then voluntarily sold Whiteacre at that price. Or suppose governmental authorities, acting under the law of the land, took Whiteacre by eminent domain and paid X \$50,000. In both such cases, where X parted with title to the land either voluntarily because he wanted to do so or where it was taken from him by laws enacted for the good of the community, there has occurred a sale or disposition of X's property that is taxed as capital gain. But in the case stated by the court, A, who has done no act and exercised no volition, has not been affected by any action that is not illegal—has not, in fact, been involved in any sale or disposition of anything—has

² *Farmers & Merchants Bank of Catlettsburg, Ky., v. Commissioner*, 59 Fed. (2d) 913 (C.C.A. 6).

Central R. Co. of New Jersey v. Commissioner, 79 Fed. (2d) 697 (C.C.A. 3). These cases are discussed in the accompanying brief (pp. 9 and 10).

³ *Eisner v. Macomber*, 252 U.S. 189.

Bowers v. Kerbaugh-Empire Co., 271 U.S. 170.

United States v. Safety Car Heating & Lighting Co., 297 U.S. 88. These cases are discussed in the accompanying brief (pp. 10 and 11).

merely been compensated for an injury—is subject to tax upon 100% of \$45,000. Is it conceivable that Congress, which provided in Section 117 for partial relief to the taxpayer in the case of the sale or disposition of capital assets and in Section 112 for complete relief in the case of involuntary conversions of capital assets would not have made provision for the taxpayer who recovered damages for injury inflicted upon him by a wrong-doer, if it had thought that such recovery would be treated as anything but diminution of a loss and might be taxed as *income*? Has not Congress assumed, rather, that the Circuit Court of Appeals decisions above referred to satisfactorily stated the law? ⁴

Furthermore, it must be remembered that the taxpayer is not enriched by the damages. He is merely compensated for the injury he has wrongfully suffered. It is purely speculative whether the good will built up before the wrong would or would not eventually be sold or disposed of so as to produce revenue to the government.

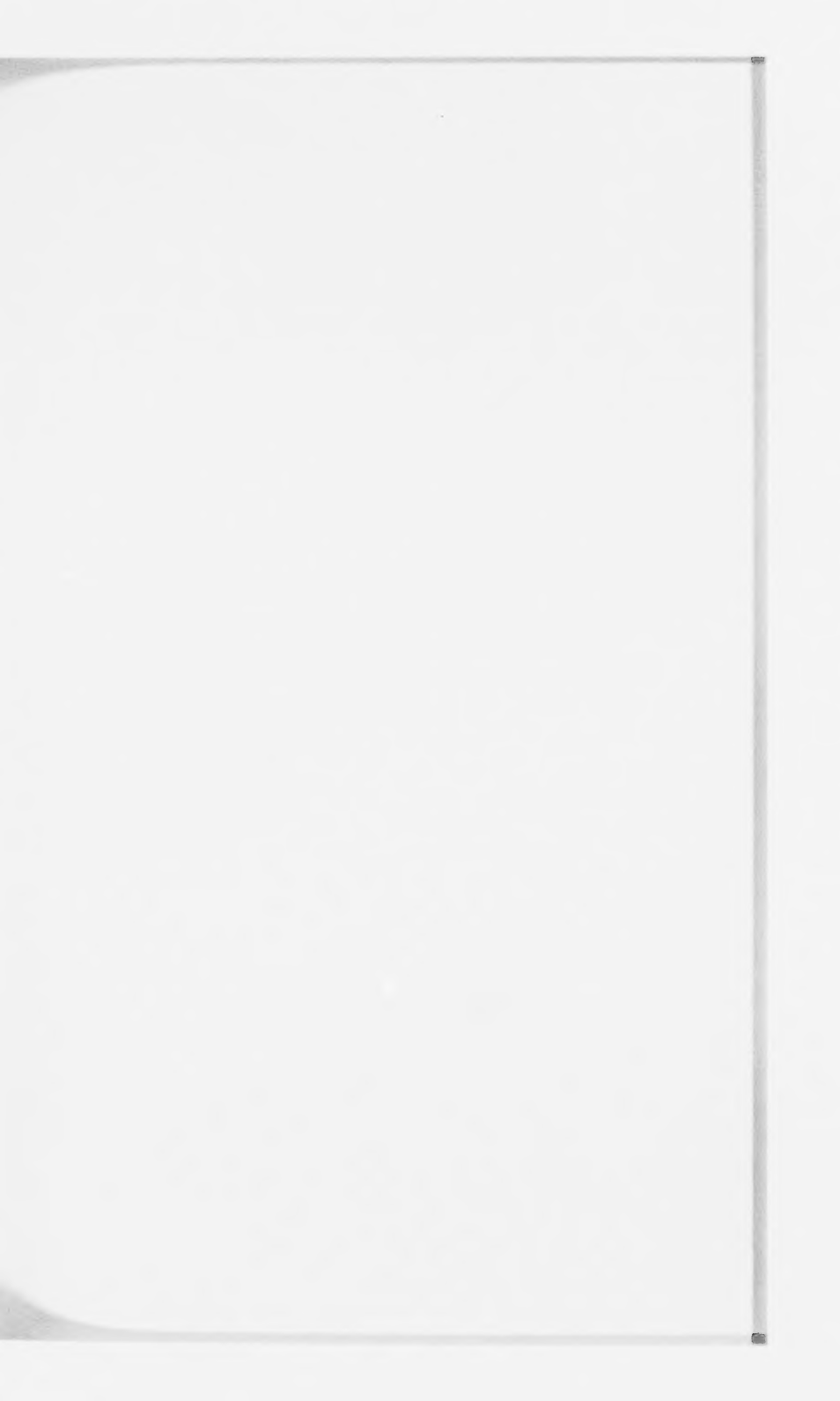
We submit that the decision below is in conflict with the decisions of other Circuit Courts of Appeals, that there is reason to believe that it is in conflict with principles laid down by this Court, and that it involves an important and basic question of federal taxation. We urge that the writ issue to resolve such conflicts and to bring about an early authoritative decision by this Court of the important question involved.

Respectfully submitted,

EDWARD C. THAYER,

Attorney for the Petitioner.

⁴ Since the decision in the *Farmers & Merchants Bank of Catlettsburg, Ky.*, case, June 27, 1932, eleven revenue acts have been passed by Congress.





BRIEF IN SUPPORT OF THE PETITION.

1. The Decision Below is in Conflict with Decisions in Other Circuit Courts of Appeals.

In *Farmers & Merchants Bank of Catlettsburg, Ky., v. Commissioner*, 59 Fed. (2d) 912 (C.C.A. 6), the bank received an amount in full settlement of a case against the Federal Reserve Bank of Cleveland in a lawsuit for damages for permanent injury to its standing, growth, and prosperity because of the malicious practices of the Reserve Bank in hampering and embarrassing it in the conduct of its affairs. This recovery was held not to constitute taxable income, the court saying:

“We think that, if the petitioner’s case had proceeded to a verdict, the law would not have awarded to it what it might have expected to gain but only that which it had actually lost . . . We think therefore that there is no logical basis upon which petitioner could be charged with gain . . . One may be recompensed for an injury, but it is a rare case in which one should have a profit out of it.”

This case is exactly in point. Both cases involved a recovery for tortious injury to the business good will, and there is nothing in the *Merchants Bank* case to indicate that there was any showing of the cost or basis of the good will injured or from which it could be inferred that any cost or basis could have been established.

In *Central R. Co. of New Jersey v. Commissioner*, 79 Fed. (2d) 697 (C.C.A. 3), property worth \$465,405 was received in settlement of a suit against the plaintiff’s officer and a corporation formed for him for damages sustained in entering into contracts and agreements with

corporations which the officer surreptitiously controlled. The recovery was held not to constitute taxable income by analogy to alimony and damages for alienation of affections, breach of promise, libel, and slander.

“Those actions are of a personal nature and do not fall within the statutory definition of income. The thought is that a recovery in such actions is compensatory . . . It is apparent then that income must come from capital or labor or both, including gains on the sale of assets. That being so, the value of the property which the taxpayer received cannot be traced to either capital or labor . . . It cannot be said that it was derived wholly or in part from the use of the taxpayer’s capital or labor. The nearest that one can come to that is to say that Joyce and his dummies could not have operated but for Joyce’s position with the taxpayer and its type of business. But Joyce’s ultra vires operations were not carried on by the use of the taxpayer’s capital and labor. They were entirely separate and apart from its business structure.”

This case is also squarely in conflict with the decision below. Both of these cases, however, are consistent with the decisions of this Court next referred to.¹

2. The Decision Below is in Conflict with Principles Announced by This Court.

In *Eisner v. Macomber*, 252 U.S. 189, the Court, developing its prior decisions in *Stratton’s Independence v.*

¹ See also *Edward N. Clark*, 40 B.T.A. 333; *Highland Farms Corporation*, 42 B.T.A. 1309.

Howbert, 231 U.S. 399, 415 and *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 185, laid down a definition of income to which it has adhered in many subsequent decisions, viz.:

“‘Income may be defined as the gain derived from capital, from labor, or from both combined,’ provided it be understood to include profit gained through a sale or conversion of capital assets.”

It is submitted that the recovery in question in this case does not fall within the foregoing definition.

In *Bowers v. Kerbaugh-Empire Co.*, 271 U.S. 170, it was decided that, where the taxpayer repaid to the Alien Property Custodian a loan from a German bank on the basis of 2½ cents per mark, no income was derived. Per Butler, J.:

“‘The loss was less than it would have been if marks had not declined in value; but the mere diminution of loss is not gain, profit or income.’”

It is submitted that the recovery in the case under consideration was a mere diminution of loss.

United States v. Safety Car Heating Co., 297 U.S. 88: In this case it was decided that the recovery of amounts received in 1925 in settlement of a suit for profits made in 1912 was taxable. For the purposes of our case what is important are the statements of Cardozo, J., at page 93:

“‘Congress intended, with exceptions not now important, to lay a tax upon the proceeds of claims or choses in action for the recovery of profits . . .’”—

and at page 98:

“‘The case is not to be confused with one where the basis of the suit is an injury to capital, with the result

that the recovery is never income, no matter when collected."

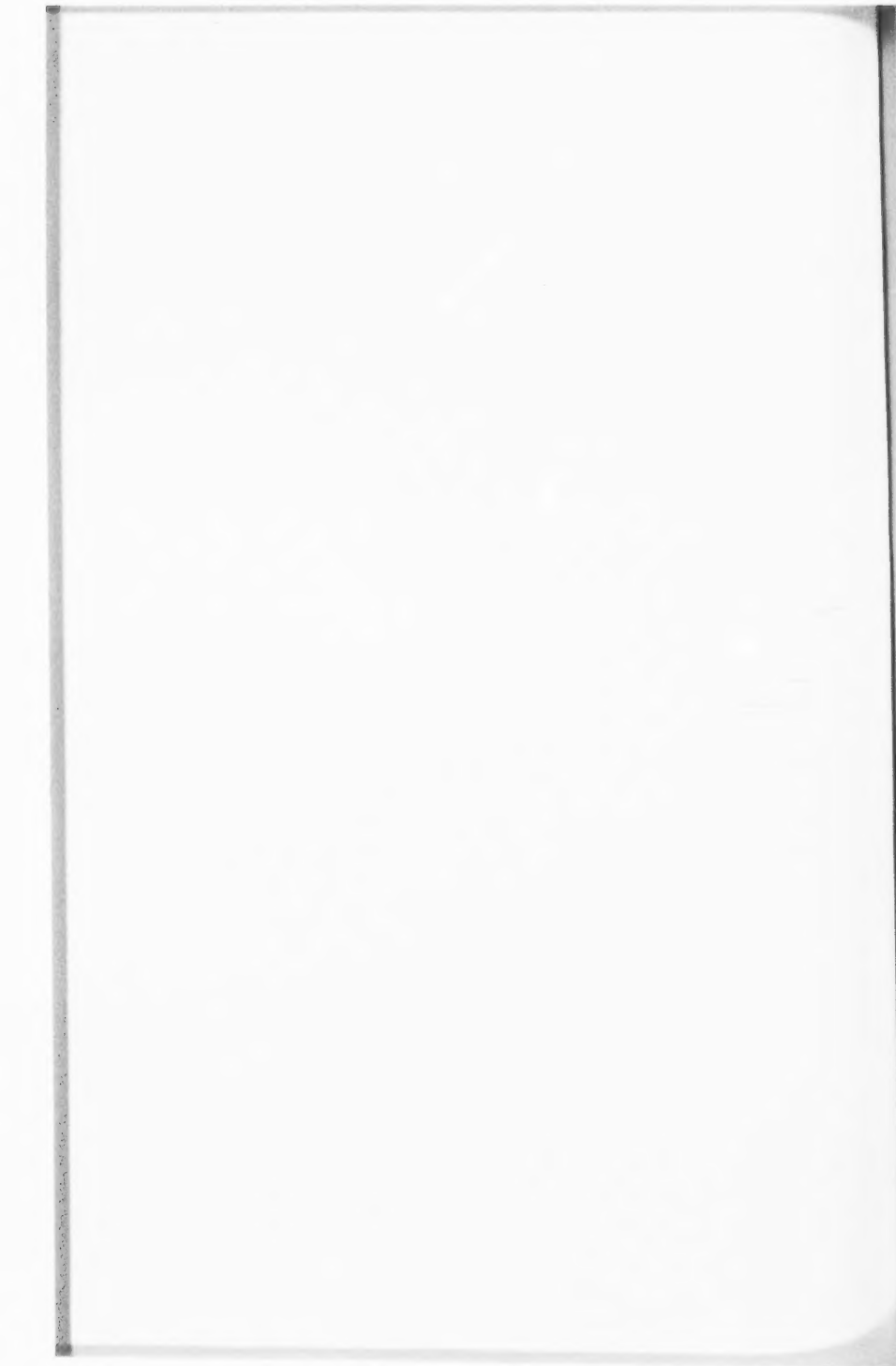
The decision below is in conflict with the quoted statements.

Respectfully submitted,

EDWARD C. THAYER,

Attorney for the Petitioner.





Appendix.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

"Sec. 22. Gross Income.

"(a) *General Definition*.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

"Section 111. Determination of Account of, and Recognition of, Gain or Loss.

"(a) *Computation of Gain or Loss*.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

* * * * *

"Sec. 112. *Recognition of Gain or Loss*.

"(a) *General Rule*.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as herein-after provided in this section.

* * * * *

“Sec. 113. *Adjusted Basis for Determining Gain or Loss.*

“(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property;

* * * * *

“(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *





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In the Supreme Court of the United States

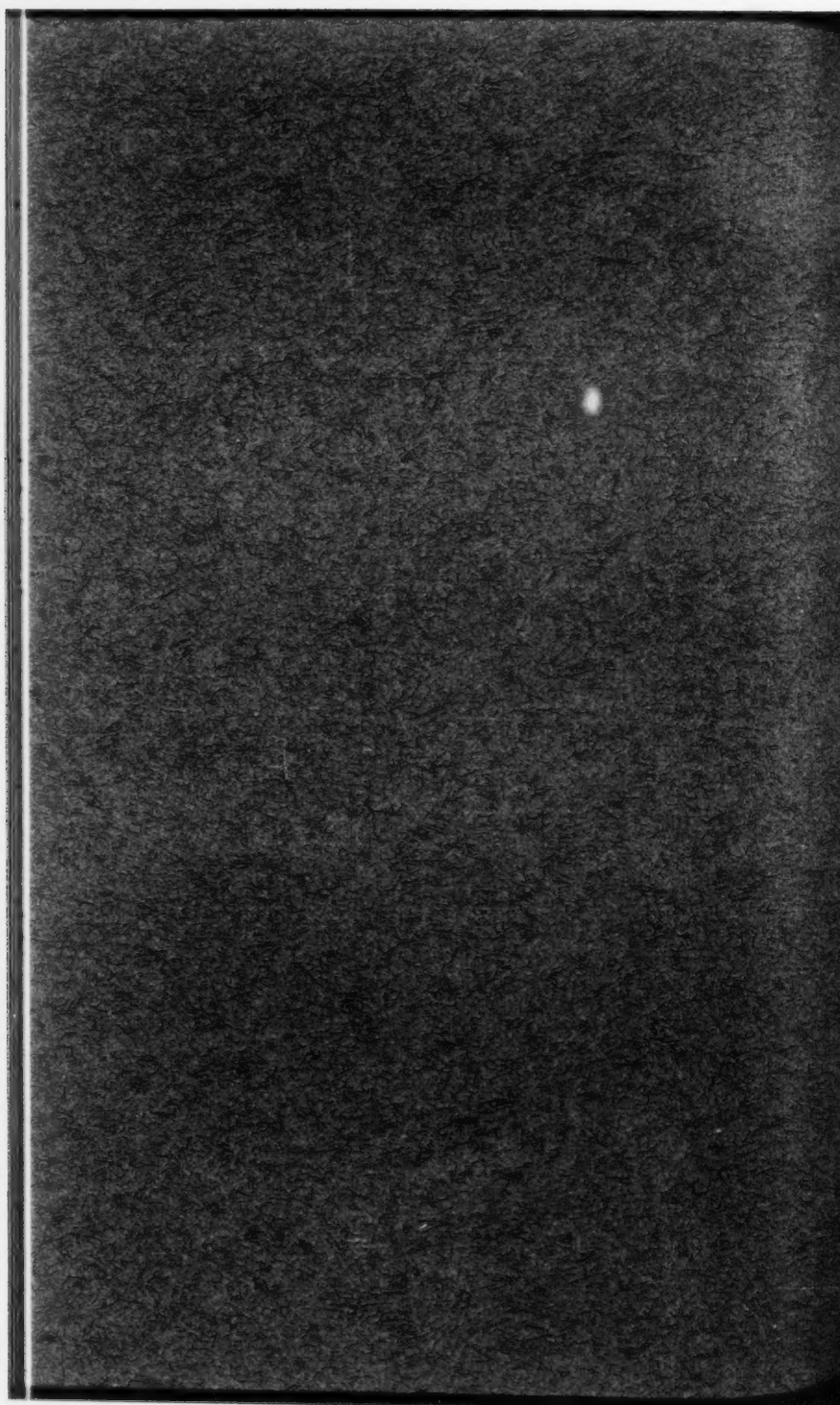
OCTOBER TERM, 1944

RAYTHEON PRODUCTION CORPORATION, PETITIONER

COMMISSIONER OF PATENT AND TRADE-MARKS, RESPONDENT

ON PETITION FOR A WRIT OF HABEAS CORPUS TO REMOVE FROM THE
STATES CIRCUIT COURT OF APPEALS FOR THE SECOND
CIRCUIT

FRANK H. HALL, ATTORNEY AT LAW, NEW YORK, N. Y.



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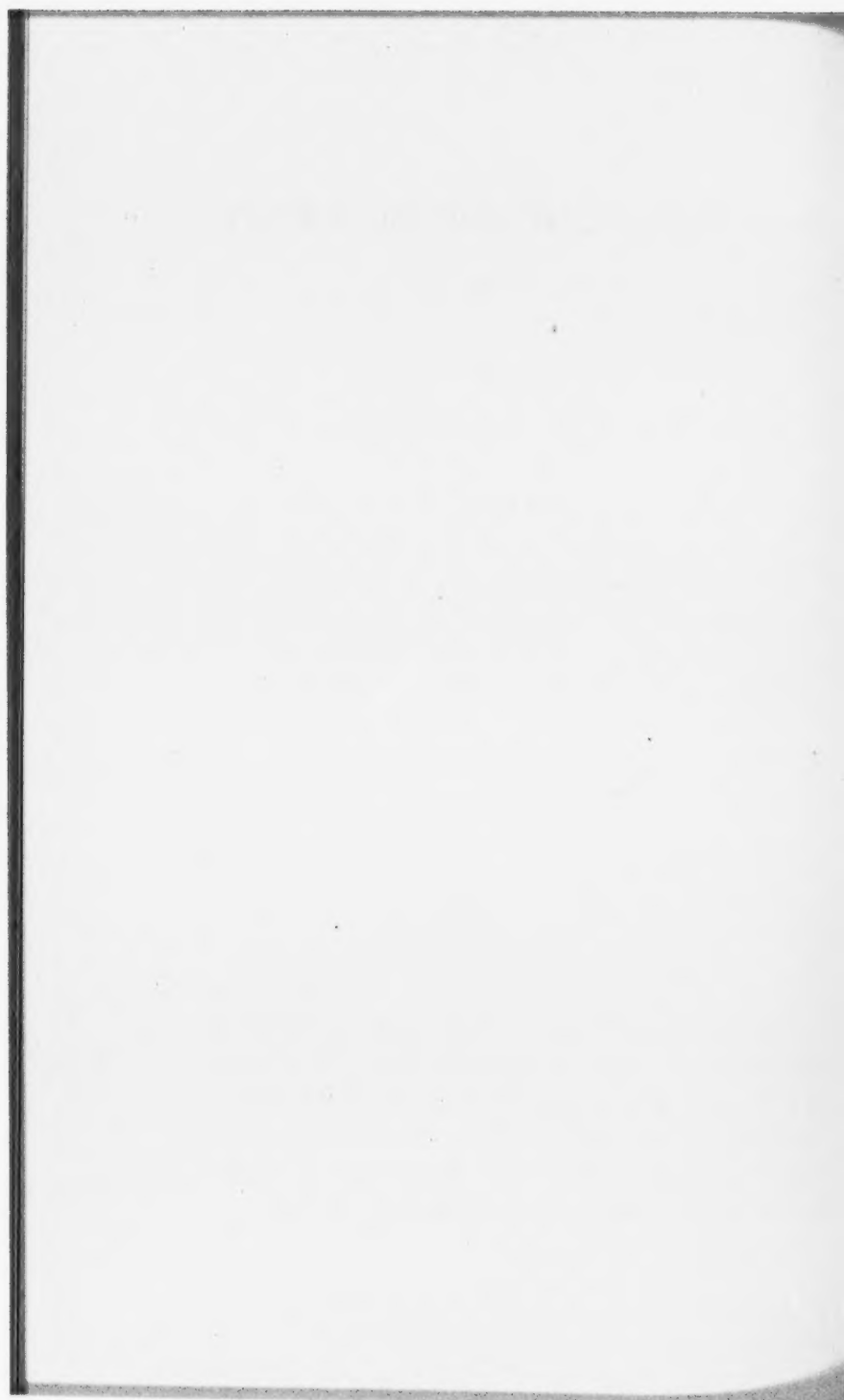
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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 609

RAYTHEON PRODUCTION CORPORATION, PETITIONER
v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE FIRST
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 16-31) are reported in 1 T. C. 952. The opinion of the Circuit Court of Appeals (R. 139-147) is reported in 144 F. 2d 110.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 28, 1944 (R. 147). The petition for a writ of certiorari was filed on October 18, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

A lump sum payment was made to the taxpayer in compromise of a suit for damages allegedly resulting from violation of the federal antitrust laws and the taxpayer failed to show the cost or other basis of its good will which had been destroyed. The question is whether the entire compromise payment is taxable income.

STATUTE INVOLVED

The pertinent statutory provisions are printed in the Appendix, *infra*, pp. 11-12.

STATEMENT

The facts as found by the Tax Court (R. 17-25) may be summarized as follows:

The taxpayer, Raytheon Production Corporation, came into existence as a result of a series of tax-free reorganizations which are not here involved. The original and successor companies will be referred to as "Raytheon". The original Raytheon Company was a pioneer manufacturer of a rectifying tube which made possible the operation of a radio receiving set on alternating current instead of on batteries. In 1926 its profits were about \$450,000; in 1927 about \$150,000; and in 1928, \$10,000. (R. 17.)

The Radio Corporation of America (hereinafter termed R. C. A.) had many patents covering radio circuits and claimed control over almost all of the

practical circuits. Cross-licensing agreements had been made among several companies including R. C. A., General Electric Company, Westinghouse, and American Telephone & Telegraph Company. R. C. A. had developed a competitive tube which produced the same type of rectification as the Raytheon tube. Early in 1927, R. C. A. began to license manufacturers of radio sets, and in the license agreement it incorporated "Clause 9", which provided that the licensee was required to buy its tubes from R. C. A. In 1928 practically all manufacturers were operating under R. C. A. licenses. As a consequence of this restriction, Raytheon was left with only replacement sales, which soon disappeared. (R. 17-18.)

When Raytheon found it impossible to market its tubes in the early part of 1929, it obtained a license from R. C. A. to manufacture tubes under the latter's patent on a royalty basis. The license agreement contained a release of all claims of Raytheon against R. C. A. by reason of the illegal acts of the latter under Clause 9, but by a side agreement such claims could be asserted if R. C. A. should pay similar claims to others. The taxpayer was informed of instances in which R. C. A. had settled claims against it based on Clause 9. On that ground it considered itself released from the agreement not to enforce its claim against R. C. A. and consequently, on December 14, 1931, the taxpayer caused its predecessor, Raytheon, to

bring suit against R. C. A. in the United States District Court for the District of Massachusetts alleging that the plaintiff had by 1926 created and then possessed a large and valuable good will in interstate commerce in rectifying tubes for radios and had a large and profitable established business therein so that the net profit for the year 1926 was \$454,935; that the business had an established prospect of large increases and that the business and good will thereof ~~was~~^{were} of a value ~~of~~ exceeding \$3,000,000; that by the beginning of 1927 the plaintiff was doing approximately 80 per cent of the business in rectifying tubes of the entire United States; that the defendant conspired to destroy the business of the plaintiff and others by a monopoly of such business and did suppress and destroy the existing companies; that the manufacturers of radio sets and others ceased to purchase tubes from the plaintiffs; that by the end of 1927 the conspiracy had completely destroyed the profitable business and that by the early part of 1928 the tube business of the plaintiff and its property and good will had been totally destroyed at a time when it had a present value in excess of \$3,000,000, and thereby the plaintiff was injured in its business and property in a sum in excess of \$3,000,000. (R. 19-20.)

The action against R. C. A. was referred to an auditor who filed a report on February 14, 1938. He found that Clause 9 was not the cause of dam-

age to the plaintiff but that the decline in plaintiff's business was due to advancement in the radio art and competition. (R. 20-21.) The auditor also found that if the plaintiff was entitled to recovery by reason of Clause 9 the damages were estimated at \$1,000,000 (R. 141).

In the spring of 1938, after the auditor's report and just prior to the time for the commencement of the trial before a jury, the Raytheon affiliated companies began negotiations for the settlement of the litigation with R. C. A. In the meantime, a suit brought by R. C. A. against the taxpayer for the non-payment of royalties resulted in a judgment of \$410,000 in favor of R. C. A. R. C. A. and the taxpayer finally agreed on the payment by R. C. A. of \$410,000 in settlement of the antitrust action. (R. 21.) A written plan of settlement was carried out under the terms of which mutual releases of any claims against the other were executed and Raytheon granted to R. C. A. certain patent license rights and sublicensing rights to a group of patents. R. C. A. declined to allocate the amount paid as between the patent license rights and the amount for the settlement of the suit. (R. 21-23.) Officials of the Raytheon companies ascribed \$60,000 of the \$410,000 to the value of the patents and allocated \$350,000 as a credit to surplus (R. 24).

In its income tax return for the fiscal year 1938, the taxpayer treated the \$350,000 as a realization

from a chose in action and not as taxable income. The Commissioner determined that the \$350,000 constituted income. (R. 24.) The Tax Court sustained the Commissioner (R. 16) and the Circuit Court of Appeals affirmed (R. 147).

ARGUMENT

This case involves the question of what part of a lump sum settlement received in compromise of litigation can be ascribed to a replacement of capital and what part to income. That is a factual question for determination by the Tax Court. *Helvering v. Nat. Grocery Co.*, 304 U. S. 282, 294; *Wilmington Co. v. Helvering*, 316 U. S. 164, 168; *Dobson v. Commissioner*, 320 U. S. 489. Apportionment, between claims for undermaintenance (a capital item) and for additional compensation (taxable income), of a lump sum settlement received by a railroad from the Director General of Railroads was held to be purely a fact question in *Southern Ry. Co. v. Commissioner*, 74 F. 2d 887, 893 (C. C. A. 4th). The facts there are strikingly similar to the instant case since no apportionment of the fund was made by the Director General. The burden of proof, in the instant case, to show what part of the payment by R. C. A. was a replacement of capital, rested upon the taxpayer and in that it failed. *Equitable Society v. Commissioner*, 321 U. S. 560, 563-564; *Burnet v. Houston*, 283 U. S. 223, 227-228.

It is immaterial whether the transfers of assets between the various companies were tax-free reorganizations or not. If we assume that they were, then the taxpayer must show the cost of the good will, alleged to have been destroyed, of Raytheon, the predecessor owner.¹ If not, the taxpayer must show its own cost for the claim or chose in action. No value was ascribed to the claim as such in any of the tax-free transfers from company to company. There is no proof of cost to any of the various corporate holders including the taxpayer. A replacement of capital loss is tax free only above the basis of cost. *Detroit Edison Co. v. Commissioner*, 319 U. S. 98, 101-102. Damages received for property seized under condemnation present a clear analogy. In such cases capital cost may be recovered tax free but any amount received above the cost basis results in taxable income. *Kieselbach v. Commissioner*, 317 U. S. 399, 404-405. And compensatory damages paid as the result of a suit for breach of warranty were held taxable as income in *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359.

The Tax Court held that the cost or other basis of Raytheon's good will and business was not shown and that therefore the amount of any non-taxable capital recovery could not be ascertained

¹ Since the taxpayer retained its physical assets, the cost basis of good will and the cost of developing its rectifier tube are the only capital items involved.

(R. 29). A similar situation existed in *Sterling v. Commissioner*, 93 F. 2d 304, 306 (C. C. A. 2d), certiorari denied, 303 U. S. 663, where the taxpayer failed to prove the March 1, 1913, value of her claim to an interest in real estate and was therefore taxed on the entire amount received in a compromise settlement of her claim.

The Circuit Court of Appeals held that compensation for the loss of Raytheon's good will in excess of its cost would be gross income and that "the record is devoid of evidence as to the amount of that basis" (R. 146). There is present here a total failure of proof which is fatal to the taxpayer's contention of a tax-exempt capital replacement. It cannot be said on this record that \$350,000, a figure arbitrarily fixed by interested officers of the taxpayer, represented a capital replacement.

The contention that damages for injury to an intangible capital asset can never be income (Pet. 7, 10-12) is not supported by the cases cited. *Bowers v. Kerbaugh-Empire Co.*, 271 U. S. 170, 172, involved a situation where the excess of losses of the taxpayer over income was more than the amount claimed by the Government to have been taxable as income in 1921. The question was whether the difference between the value of marks measured by dollars at the time of repayment of a loan and the value when the loans were made was income. The facts showed continuous losses

in 1913 to 1918 and this Court said (271 U. S. at p. 175): "The result of the whole transaction was a loss". Cf. *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359.

While this Court in *United States v. Safety Car Heating Co.*, 297 U. S. 88, 98, referred to an injury to capital as not resulting in income, the facts in that case show that the recovery was less than the March 1, 1913, value. The dictum relied on by the taxpayer (Pet. 11-12) cannot be given the effect of overruling the well-established doctrine that capital gains constitute taxable income.

We do not find a conflict among the decisions of the Circuit Courts of Appeals as contended (Pet. 7, 9-10). As pointed out by the Circuit Court of Appeals (R. 146-147) in *Farmers' & Merchants' Bank v. Commissioner*, 59 F. 2d 912 (C. C. A. 6th), the plaintiff's bank business was injured and the compensation paid was to recoup for the injury. The court's reasoning merely deals with the nature of the recovery and it assumes that since the recovery was not for lost profits, it did not constitute income. It may not be interpreted as a clear holding that a recovery of capital is not income even though in excess of the basis. See *Davis v. Commissioner*, 35 B. T. A. 1001, 1013-1015.

Central R. Co. v. Commissioner, 79 F. 2d 697 (C. C. A. 3d), involved the question whether the amounts realized through impressing a trust upon

the earnings of a fiduciary could properly be treated as income of the *cestui*. The court held (79 F. 2d at p. 699) that the amount received was not income of the railroad but a penalty imposed by law on a faithless fiduciary named Joyce for double dealing. The ultra vires operations of the fiduciary were not carried on by the use of the capital and labor of the railroad but were separate and apart from the latter's business structure.

Both of the above cases are discussed in *Sterling v. Commissioner*, 93 F. 2d 304, 306 (C. C. A. 2d), in which this Court denied a petition for certiorari, 303 U. S. 663.

CONCLUSION

The decision below is correct. There is no conflict of decisions and the petition for certiorari should be denied.

Respectfully submitted.

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NOVEMBER 1944.



APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized. * * *

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General Rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

(5) *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property;

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(2) *Substituted Basis.*—The term “substituted basis” as used in this subsection means a basis determined under any provision of subsection (a) of this section or under any corresponding provision of a prior income tax law, providing that the basis shall be determined—

(A) by reference to the basis in the hands of a transferor, donor, or grantor, or

